

**COUNTY OF ORANGE
INTEGRATED WASTE
MANAGEMENT DEPARTMENT**
(A Enterprise Fund of the
County of Orange, California)

Independent Auditor's Reports
and Financial Statements

For the Years Ended June 30, 2003 and 2002

**COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
FOR THE YEARS ENDED JUNE 30, 2003 AND 2002**

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Macias, Gini & Company LLP
Certified Public Accountants and
Management Consultants

515 South Figueroa Street
Suite 325
Los Angeles, CA 90071

213•612•0200
213•286•6426 FAX
www.maciasgini.com

Board of Supervisors
County of Orange, California

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the County of Orange Integrated Waste Management Department (IWMD), an enterprise fund of the County of Orange, California (County), as of June 30, 2003 and 2002, as listed in the table of contents. These financial statements are the responsibility of IWMD's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2, the financial statements present only IWMD and do not purport to, and do not, present fairly the financial position of the County as of June 30, 2003 and 2002, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the County of Orange Integrated Waste Management Department as of June 30, 2003 and 2002, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 23, 2003 on our consideration of the IWMD's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants for the year ended June 30, 2003. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Maassar, Jini & Company LLP
Certified Public Accountants

Los Angeles, California
October 23, 2003

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
STATEMENTS OF NET ASSETS
JUNE 30, 2003 AND 2002
(in thousands)

	<u>2003</u>	<u>2002</u>
ASSETS:		
Current assets:		
Pooled cash and investments (Note 3)	\$ 216,924	\$ 217,297
Imprest cash funds (Note 3)	35	35
Accounts receivable, net of allowances of \$13 in 2003 and \$12 in 2002	12,117	10,081
Interest receivable	913	2,141
Due from other governmental agencies	682	452
Due from County of Orange	379	43
Total current assets	<u>231,050</u>	<u>230,049</u>
Noncurrent assets:		
Restricted assets:		
Pooled cash and investments-rate stabilization (Note 3)	20,173	21,658
Pooled cash and investments-closure and postclosure care costs (Note 3 and 8)	141,528	120,913
Pooled cash and investments-customer deposits (Note 3)	587	1,781
Investments with trustees (Note 3)	10,249	9,987
Deposits in-lieu of cash (Note 4)	17,564	16,469
Total restricted assets	<u>190,101</u>	<u>170,808</u>
Capital assets: (Note 5)		
Nondepreciable	40,869	40,303
Depreciable, net	159,902	149,862
Net capital assets	<u>200,771</u>	<u>190,165</u>
Debt issuance costs	<u>701</u>	<u>1,050</u>
Total noncurrent assets	<u>391,573</u>	<u>362,023</u>
Total Assets	<u>\$ 622,623</u>	<u>\$ 592,072</u>

See accompanying notes to financial statements.

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
STATEMENTS OF NET ASSETS (Continued)
JUNE 30, 2003 AND 2002
(in thousands)

	<u>2003</u>	<u>2002</u>
LIABILITIES:		
Current liabilities (payable from current assets):		
Accounts payable	\$ 6,499	\$ 6,693
Salaries and accrued employee benefits payable	667	550
Deferred revenue	1	-
Compensated employee absences payable	1,333	247
Arbitrage rebate payable	-	245
Due to County of Orange	3,621	2,938
Due to other governmental agencies	2,079	1,859
Total current liabilities (payable from current assets)	<u>14,200</u>	<u>12,532</u>
Current liabilities (payable from restricted assets):		
Revenue bonds payable, net (Note 7)	3,717	3,512
Accrued closure and postclosure care costs (Notes 7 and 8)	9,284	5,209
Interest payable	268	282
Deposits from others	18,150	18,250
Total current liabilities (payable from restricted assets)	<u>31,419</u>	<u>27,253</u>
Total current liabilities	<u>45,619</u>	<u>39,785</u>
Noncurrent liabilities:		
Arbitrage rebate payable	31	-
Compensated employee absences payable (Note 7)	1,597	1,590
Accrued closure and postclosure care costs (Notes 7 and 8)	171,937	168,282
Revenue bonds payable, net (Note 7)	53,166	56,883
Total noncurrent liabilities	<u>226,731</u>	<u>226,755</u>
Total Liabilities	<u>272,350</u>	<u>266,540</u>
NET ASSETS		
Invested in capital assets, net of related debt	144,589	130,538
Restricted	163,515	143,343
Unrestricted	42,169	51,651
Total Net Assets	<u><u>\$ 350,273</u></u>	<u><u>\$ 325,532</u></u>

See accompanying notes to financial statements.

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2003 AND 2002
(in thousands)

	<u>2003</u>	<u>2002</u>
OPERATING REVENUES		
Disposal fees (Note 1)	\$ 107,210	\$ 103,216
Use of property	571	585
Licenses, permits, and franchises	22	62
Other	201	417
Total operating revenues	<u>108,004</u>	<u>104,280</u>
OPERATING EXPENSES		
Salaries and employee benefits	18,169	16,206
Services and supplies	2,059	2,485
Professional and specialized services	12,042	10,099
Equipment operating leases	438	2,903
Land operating lease	478	552
Transportation	1,596	1,392
Contributions to other agencies	8,429	8,171
Ground and structure maintenance	1,742	2,570
Equipment maintenance	6,698	5,305
Provision for closure and postclosure care costs (Notes 2 and 8)	13,165	7,239
Depreciation and amortization	10,311	11,218
Other expense	-	12
Total operating expenses	<u>75,127</u>	<u>68,152</u>
Operating income	32,877	36,128
NONOPERATING REVENUES (EXPENSES)		
Intergovernmental revenue	376	19
Fines, forfeitures and penalties	18	25
Interest income	7,368	11,549
Interest expense	(3,674)	(3,853)
Loss on disposal of capital assets	(180)	(151)
Other	(107)	-
Total nonoperating revenues (expenses)	<u>3,801</u>	<u>7,589</u>
Income before contributions and transfers	36,678	43,717
Capital contributions	1,499	-
Transfers to County General Fund (Note 1)	(13,436)	(12,796)
Total contributions and transfers	<u>(11,937)</u>	<u>(12,796)</u>
Change in net assets	24,741	30,921
Net Assets - Beginning of Year	325,532	294,611
Net Assets - End of Year	<u>\$ 350,273</u>	<u>\$ 325,532</u>

See accompanying notes to financial statements.

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2003 AND 2002
(in thousands)

	<u>2003</u>	<u>2002</u>
Cash flows from operating activities		
Receipts from customers	\$ 104,544	\$ 106,312
Payments to suppliers for goods and services	(24,331)	(21,142)
Payments to employees for services	(16,959)	(15,601)
Cash paid for interfund charges	(1,251)	(250)
Landfill site closure disbursements	(5,435)	(415)
Contributions to other agencies	(8,209)	(8,171)
Other payments	(1,219)	(3,462)
Net cash provided by operating activities	<u>47,140</u>	<u>57,271</u>
Cash flows from noncapital and related financing activities		
Transfers out	(12,753)	(12,796)
Intergovernmental revenues	376	(16)
Net cash used in noncapital and related financing activities	<u>(12,377)</u>	<u>(12,812)</u>
Cash flows from capital and related financing activities		
Acquisition of capital assets	(19,727)	(24,515)
Principal paid on bonds	(3,905)	(3,730)
Interest paid on bonds	(2,946)	(3,437)
Proceeds from sale of capital assets	132	20
Net cash used in capital and related financing activities	<u>(26,446)</u>	<u>(31,662)</u>
Cash flows from investing activities		
Interest on investments	9,508	13,760
Sale/maturities (purchase) of investments	(262)	41
Net cash provided by investing activities	<u>9,246</u>	<u>13,801</u>
Net increase in cash and cash equivalents	17,563	26,598
Cash and cash equivalents at beginning of year	361,684	335,086
Cash and cash equivalents at end of year	<u><u>\$ 379,247</u></u>	<u><u>\$ 361,684</u></u>

See accompanying notes to financial statements.

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2003 AND 2002
(in thousands)

	<u>2003</u>	<u>2002</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 32,877	\$ 36,128
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	10,311	11,218
Provision for landfill site closure/postclosure costs	13,165	7,239
Landfill site closure disbursements	(5,435)	(415)
Other income	(89)	-
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Accounts receivable	(2,036)	704
Due from County of Orange	(1,482)	438
Deposits in-lieu of cash	(1,095)	2,552
Increase (decrease) in:		
Accounts payable	(193)	709
Salaries and employee benefits payable	117	39
Deferred revenue	1	-
Deposits from others	(100)	(1,224)
Due to County of Orange	-	(688)
Due to other governmental agencies	220	(63)
Compensated employee absences payable	1,093	566
Arbitrage rebate payable	(214)	68
Net cash provided by operating activities	<u>\$ 47,140</u>	<u>\$ 57,271</u>
Reconciliation of cash and cash equivalents to statements of net assets:		
Pooled cash and investments-current assets	\$ 216,924	\$ 217,297
Pooled cash and investments-closure and postclosure care costs	141,528	120,913
Pooled cash and investments-rate stabilization	20,173	21,658
Pooled cash and investments-customer deposits	587	1,781
Imprest cash funds	35	35
	<u>\$ 379,247</u>	<u>\$ 361,684</u>
Schedule of Noncash Investing, Capital, and Financing Activities - Capital contribution	\$ 1,499	\$ -

See accompanying notes to financial statements.

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2003 AND 2002
(in thousands)

NOTE 1 - COUNTY BANKRUPTCY RECOVERY

On December 6, 1994, the County of Orange, California (County), filed for protection under Chapter 9 of the United States Bankruptcy Code as a result of substantial losses in the Orange County Investment Pool (Pool). The liquidation of the portfolio resulted in the realization of an investment loss of approximately \$1.6 billion. Approximately \$36,652 of the County's loss was allocated to the Integrated Waste Management Department (IWMD) operations and finances and was reported in the year ended June 30, 1995.

In response to the bankruptcy, the County prepared a comprehensive recovery plan (Plan). The Plan was confirmed by the United States Bankruptcy Court for the Central District of California in its Order Confirming Modified Second Amended Plan of Adjustment entered on May 16, 1996. On June 12, 1996, the Plan became effective and the County emerged from bankruptcy.

Impact of County Bankruptcy on Integrated Waste Management Department

IWMD is a department of the County. Due to statutory and regulatory restrictions, revenues generated by IWMD from in-county waste are not available for County General Fund purposes. After analyzing its assets and operations, the County determined that IWMD could provide an important source of revenue for the repayment of County claims. As such, the County proposed to restructure the operations of IWMD to maximize its value. Specifically, the County proposed to import out-of-county waste as a new source of revenue. Pursuant to the proposal, the County obtained legislation exempting IWMD from certain provisions of the California Environmental Quality Act, thereby allowing the County to pursue and contract for the importation of out-of-county waste.

The County requested proposals for waste-importation contracts and, in January 1996, entered into contracts of various durations. These contracts are estimated to generate revenue sufficient to support the plan's estimated \$15 million of net importation revenue to be contributed to the County General Fund to pay bankruptcy related obligations. During the years ended June 30, 2003 and 2002, IWMD collected imported waste disposal fees of \$22,590 and \$20,401, respectively. Net import revenues totaling \$12,753 and \$12,796 were distributed to the County during the years ended June 30, 2003 and 2002, respectively, and are included in Transfers to County General Fund in the financial statements.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Reporting Entity

IWMD is a department of the County and is included as an enterprise fund in the basic financial statements of the County.

The County assumed responsibility for establishing and maintaining waste disposal sites in 1946, on the other hand, IWMD enterprise fund was formally established in 1982. IWMD finances its operations through disposal fees charged to users of the waste disposal sites. Such disposal fees are IWMD's primary source of revenue.

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2003 AND 2002
(in thousands)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Disposal fees from two major customers accounted for revenues of approximately \$27,463 and \$23,070 during the year ended June 30, 2003 and \$24,024 and \$22,484 during the year ended June 30, 2002.

As of June 30, 2003, the County continues to maintain waste disposal agreements with 31 cities, 3 sanitary districts and 13 haulers. The waste disposal agreements cover approximately 85% of all solid waste generated in the County and obligate the cities and haulers to deliver all controllable waste to landfills operated by IWMD. The 15% balance of in-county waste is delivered by self-haulers. The initial term of the waste disposal agreements is ten years with an option to renew for an additional ten years.

Implementation of New Governmental Accounting Standards Board Pronouncements

Statement No. 40

In March 2003, GASB issued Statement No. 40, *Deposit and Investment Risk Disclosures- an Amendment of GASB Statement No. 3*. The statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this statement also should be disclosed. This statement is effective for financial periods beginning after June 15, 2004. The County Treasurer is planning to implement the new reporting requirements for the fiscal year 2003-2004 financial statements.

Basis of Presentation – Fund Accounting

The operations of IWMD are accounted for as an enterprise fund. Enterprise funds are used to account for activities that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that costs of providing services to the general public on a continuing basis be financed or recovered primarily through user charges. IWMD has elected not to apply Financial Accounting Standards Board pronouncements issued after November 30, 1989.

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2003 AND 2002
(in thousands)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Accounting

IWMD prepares its financial statements on the accrual basis of accounting in conformity with generally accepted accounting principles, which provides that revenues are recorded when earned and expenses are recorded when incurred. Grants are recorded as revenues when earned.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Operating/Nonoperating Revenues and Expenses

The IWMD distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services from the IWMD's landfill operations. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents are defined as short-term, highly liquid investments, which are readily convertible to cash or mature within three months of their original purchase. Pooled cash and investments are considered cash and cash equivalents.

Pooled Cash and Investments and Investments with Trustees

Pooled cash and investments and investments with trustees are stated at fair value. Pooled cash and investments are funds IWMD has on deposit with the Orange County Treasurer's County Investment Pool (Pool). Interest earned on pooled cash and investments is allocated monthly by the Treasurer to IWMD based on average daily balances on deposit with the Treasurer. Interest earned on investments with trustees is credited directly to IWMD.

Capital Assets

Property, plant and equipment purchased or constructed by IWMD are capitalized at cost, while contributed properties are recorded at fair market value when received. Assets are capitalized when the original unit cost is equal to or greater than the County's capitalization threshold of \$5 for equipment and \$150 for structures and improvements. Depreciation is provided on a straight-line basis over the estimated useful lives of the related assets, which range from 3 to 20 years for equipment and 10 to 50 years for structures and improvements. No depreciation is provided on construction in progress until construction is completed and the asset is placed in service.

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2003 AND 2002
(in thousands)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Maintenance and repair costs are expensed in the period incurred. Expenditures that materially increase the capacity or efficiency or extend the useful life of an asset are capitalized and depreciated. Upon the sale or retirement of the capital asset, the cost and related accumulated depreciation, if applicable, are eliminated from the respective accounts and any resulting gain or loss is included in the Statement of Revenue, Expenses and Changes in Net Assets.

Interest is capitalized on construction in progress. Capitalized interest is the total interest cost from the date of the borrowing, net of any allowable interest earned on temporary investments. There was no net interest capitalized in 2003 or 2002.

Debt Issuance Costs, Premiums and Deferred Charges on Refundings

Debt issuance costs, premiums and deferred charges on refundings are amortized on a straight-line basis over the term of the debt.

Landfill Closure and Postclosure Care Costs

IWMD accrues a liability for anticipated costs of closing landfill sites plus the costs of monitoring and maintaining the sites during the postclosure periods. Because the closure expenses are accrued over the life of the operating landfills as the permitted air space of the landfills is consumed, the entire closure and postclosure care cost is recognized as an expense by the time the landfills are completely filled. IWMD accrues for the estimated costs of closing landfill sites over the estimated useful lives of the sites based on engineering studies and cost projections, and for the estimated costs of monitoring and maintaining the sites during the postclosure period.

Self-Insurance

The County purchases IWMD liability insurance coverage and the related insurance premium is recorded as an IWMD operating expense. IWMD also participates in the County's self-insured programs for general and automobile liability insurance, workers' compensation, group health indemnified plans, group salary continuance plan, group dental plan and unemployment benefits plan. IWMD records its portion of related self-insurance premiums charged by the County as an expense. The related liabilities are accrued by the County's self-insurance funds based on estimated future amounts to be paid on known claims and incurred but not reported claims, including loss adjustment expenses. Insurance expense for the year ended June 30, 2003 was \$82 versus a refund of (\$192) for the year ended June 30, 2002.

Compensated Absences

Compensated employee absences (vacation, compensatory time off, performance incentive plan (PIP) time off, annual leave and sick leave) are accrued as an expense and liability when incurred.

Reclassifications

Certain reclassifications have been made to 2002 amounts to conform to the 2003 presentation

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2003 AND 2002
(in thousands)

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Net Assets

Net Assets are displayed in three distinct categories.

Invested in capital assets, net of related debt indicates the value of land, buildings, infrastructure, and equipment less debt related to the acquisition of those assets that is representative of the IWMD's equity in capital assets.

Restricted indicates the value of the Restricted Assets on hand and pooled cash and investments – closure and postclosure care costs in excess of the related and recognized liabilities. It is expected that future liabilities will be recognized to match the restricted assets on hand. These monies are reserved by federal and state legislation for particular use within their particular categories.

Unrestricted is the remaining amount of assets over liabilities available for operations and management discretion.

NOTE 3 - CASH AND INVESTMENTS

IWMD's investment policy guidelines provide for pooling its cash and investments with the County Treasurer and allows for the same types of investments as the County.

Pooled Cash and Investments

As discussed in Note 2, the Treasurer maintains the Pool for the County and other non-County entities for the purpose of benefiting from economies of scale through pooled investment activities. At June 30, 2003 and 2002, the Pool contains investments with an average maturity of 153 and 179 days, respectively. Interest is apportioned to individual funds based on the average daily balances on deposit with the Treasurer.

Additional information regarding insurance, collateralization, and custodial credit risk categorization of the Pool is presented in Note 3 of the County's basic financial statements.

Deposits with Trustees

At year-end 2003 and 2002, IWMD's carrying amount of deposits with trustee was \$607. Of the deposits with trustee balance, \$100 was insured by the Federal Deposit Insurance Corporation (FDIC) and is classified as Category 1. The remaining \$507 is uninsured, but collateralized with securities held by the pledging financial institution's trust department or agent in IWMD's name.

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2003 AND 2002
(in thousands)

NOTE 3 - CASH AND INVESTMENTS (CONTINUED)

Investments with Trustees

On behalf of IWMD, fiscal agents hold and invest proceeds from long-term debt issuances as required by the indentures. Fiscal agents are mandated by the indentures as to the types of investments in which the debt issuance proceeds can be invested.

Classification by Custodial Credit Risk

Investments are categorized to provide a description of the level of custodial credit risk assumed by IWMD. Category 1 investments are insured or registered, or securities are held by IWMD or its agent in IWMD's name. Category 2 investments are uninsured and unregistered, with securities held by the counterparty's trust department or agent in IWMD's name. Category 3 investments are uninsured and unregistered, with securities held by the counterparty, or by the counterparty's trust department or agent, but not in IWMD's name.

Except for IWMD's investments with trustees, all of IWMD's cash and investments are combined with the County's pooled investments, and therefore, do not represent specific identifiable investments.

Investments were categorized at June 30 as follows:

	2003	2002
Category 2 investments:		
U.S. Government securities	\$ 7,205	\$ 7,205
Non-categorized investments and deposits:		
Cash and investments pooled by the County Treasurer	379,212	361,649
Imprest cash funds	35	35
Mutual funds	2,437	2,175
Total investments	<u>\$ 388,889</u>	<u>\$ 371,064</u>
	2003	2002
Total deposits	\$ 607	\$ 607
Total investments	388,889	371,064
Total cash and investments	<u>\$ 389,496</u>	<u>\$ 371,671</u>

NOTE 4 - DEPOSITS IN-LIEU OF CASH

IWMD requires security deposits from landfill deferred payment program users. These security deposits are comprised primarily of certificates of deposit and security bonds, which are held by IWMD.

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2003 AND 2002
(in thousands)

NOTE 5 – CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2003 was as follows:

	Balance July 1, 2002	Additions	Retirements	Transfers & Adjustments	Balance June 30, 2003
<i>Capital assets, nondepreciable:</i>					
Land	\$ 17,070	\$ 1,360	\$ -	\$ -	\$ 18,430
Construction in progress	23,233	15,691	-	(16,485)	22,439
Total capital assets, nondepreciable	40,303	17,051	-	(16,485)	40,869
<i>Capital assets, depreciable:</i>					
Buildings and improvements	5,477	732	-	295	6,504
Equipment	37,674	4,047	(3,284)	-	38,437
Infrastructure	168,389	-	-	16,190	184,579
Total capital assets, depreciable	211,540	4,779	(3,284)	16,485	229,520
<i>Less accumulated depreciation for:</i>					
Buildings and improvements	(2,264)	(886)	-	-	(3,150)
Equipment	(17,435)	(2,886)	2,969	-	(17,352)
Infrastructure	(41,979)	(7,137)	-	-	(49,116)
Total accumulated depreciation	(61,678)	(10,909)	2,969	-	(69,618)
Total capital assets, being depreciated, net	149,862	(6,130)	(315)	16,485	159,902
Total capital assets, net	\$ 190,165	\$ 10,921	\$ (315)	\$ -	\$ 200,771

Capital asset activity for the year ended June 30, 2002 was as follows:

	Balance July 1, 2001	Additions	Retirements	Transfers & Adjustments	Balance June 30, 2002
<i>Capital assets, nondepreciable:</i>					
Land	\$ 17,070	\$ -	\$ -	\$ -	\$ 17,070
Construction in progress	22,820	13,656	-	(13,243)	23,233
Total capital assets, nondepreciable	39,890	13,656	-	(13,243)	40,303
<i>Capital assets, depreciable:</i>					
Buildings and improvements	5,042	-	-	435	5,477
Equipment	28,440	10,859	(1,625)	-	37,674
Infrastructure	155,772	-	-	12,617	168,389
Total capital assets, depreciable	189,254	10,859	(1,625)	13,052	211,540
<i>Less accumulated depreciation for:</i>					
Buildings and improvements		(872)	-	248	(2,264)
Equipment		(2,241)	1,454	191	(17,435)
Infrastructure		(8,105)	-	(248)	(41,979)
Total accumulated depreciation		(11,218)	1,454	191	(61,678)
Total capital assets, being depreciated, net	137,149	(359)	(171)	13,243	149,862
Total capital assets, net	\$ 177,039	\$ 13,297	\$ (171)	\$ -	\$ 190,165

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2003 AND 2002
(in thousands)

NOTE 5 – CAPITAL ASSETS (CONTINUED)

Construction in progress

Construction in progress consists of projects for drainage systems, water irrigation and collection systems, gas collection systems, monitoring systems, landfill grading and re-vegetation. The projects at June 30 are as follows:

Landfill	2003	2002
Frank R. Bowerman (FRB)		
Phase VIII Slide Stabilization	\$ 3,381	\$ -
Phase VD Construction	-	5,292
Phase VD CM/CQA	2,687	1,765
Olinda Alpha		
Offsite Access Road – Acquisition/Relocation	-	1,390
Valencia Wide Project Phase 2	-	2,061
Prima Deshecha		
Zone 1 Phase A and B CM/CQA/AP	2,635	1,905
Zone 1 Phase B Mass Excavation	7,581	3,345
Master Plan/Permitting	2,800	3,487
Other	3,355	3,988
Total construction in progress	<u>\$ 22,439</u>	<u>\$ 23,233</u>

Construction Contracts

IWMD entered into various construction contracts to facilitate its landfill operations. At June 30, 2003, IWMD is committed to open construction contracts for the following projects:

Description	Amount
Zone I Phase B Mass Excavation	\$ 13,500
FRB Phase VIII Slide Stabilization	3,391
FRB Maintenance Facility	1,200
Total	<u>\$ 18,091</u>

COUNTY OF ORANGE
INTEGRATED WASTE MANAGEMENT DEPARTMENT
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2003 AND 2002
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NOTE 6 - DEFINED BENEFIT PENSION PLAN

All full-time employees of IWMD participate in the Orange County Employees Retirement System ("OCERS"), which is a cost-sharing, multiple-employer, defined benefit pension plan. OCERS provides for retirement, death, disability and cost-of-living benefits, and is subject to the provisions of the County Employees Retirement Act of 1937 and other applicable statutes.

Members employed after September 20, 1979, are designated as Tier II members. Members employed prior to September 21, 1979, are designated as Tier I members; the establishment of Tier II resulted in a reduced allowance beginning at age 50. The retirement allowance is based upon the member's age at retirement, final compensation, and the total years of service under the system. If an employee terminates before rendering five years of service, the employee forfeits the right to receive benefits and is entitled to withdraw employee contributions made together with accumulated interest. If an employee terminates after five years of service, the employee may elect to leave the accumulated deposits in the retirement fund and be granted a deferred retirement allowance at the time the member would have been entitled to the allowance if service had been continued.

OCERS issues a stand-alone annual financial report, which can be obtained by writing to the Orange County Employees Retirement System, 2223 Wellington Avenue, Santa Ana, CA 92701 or by calling (714) 558-6200.

In accordance with various Board of Supervisors' resolutions, the County's funding policy is to make periodic contributions to OCERS in amounts such that, when combined with employees' contributions and with investment income, will fully provide for all employees' benefits by the time they retire. From July 2002 through June 2003 employer's contributions, as a percentage of covered payroll were 5.66% for General members. From July 2000 through June 2002 employer's contributions as a percentage of covered payroll were .96% for General members.

Covered employees are required to contribute a percentage of their annual compensation to OCERS as a condition of employment. For Tier I members, the normal rate of contribution is based on the member's age at entry in OCERS, and is calculated to provide an annual annuity equal to 1/200 of the member's "final compensation" for each year of service rendered at age 60 for General members. For Tier II General members, the rate of contribution is calculated to provide an annual annuity equal to 1/120 of the member's "final compensation" for each year of service rendered at age 60.

The pension liability or asset at transition was calculated in accordance with the provisions of GASB Statement No. 27 and was zero at transition and the effective date.

IWMD's total payroll was \$15,065, \$13,212 and \$12,400 and the payroll for employees covered by OCERS was \$14,148, \$12,338 and \$12,010 for the years ended June 30, 2003, 2002 and 2001, respectively. Total pension expense (which equals the actuarially required contributions) for IWMD was \$ 787, \$215 and \$144 for the years ended June 30, 2003, 2002 and 2001, respectively.

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)
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NOTE 7 - LONG-TERM DEBT

1997 Refunding Revenue Bonds

In November 1997, the Orange County Public Financing Corporation (OCPFC) issued \$77,300 in revenue bonds, with interest rates ranging from 4.375% to 5.75%, to advance refund the 1988 Certificates of Participation, with interest rates ranging from 7.20% to 7.875%, which were originally issued in December 1988 maturing in installments through December 1, 2013. These refunding revenue bonds are payable from IWMD's net operating revenues and are not a general obligation of the County. The bonds were issued at a premium of \$2,190.

The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$7,274. In accordance with GASB Statement No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*, this difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through fiscal year 2014 using the effective interest method. IWMD completed the advance refunding to reduce its total debt service payments over the next 17 years by \$22,764 and to obtain an economic gain (difference between the present value of the old and new service payments) of \$17,128.

Annual Principal and Interest Requirements

Annual debt service requirements for the outstanding revenue bonds as of June 30, 2003, excluding the premium and deferred charges on refunding, are as follows:

Year Ending June 30,	Principal	Interest
2004	\$ 4,080	\$ 3,121
2005	4,280	2,919
2006	4,515	2,687
2007	4,760	2,441
2008	5,030	2,176
2009-2013	29,840	6,170
2014	7,020	184
Total 1997 Refunding Revenue Bonds	<u>\$ 59,525</u>	<u>\$ 19,698</u>

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NOTE 7 - LONG-TERM DEBT (CONTINUED)

Long-term liability activities for the year ended June 30, 2003 were as follows:

Long-Term Liabilities	Balance July 1, 2002	Additions	Reductions	Balance June 30, 2003	Due Within One Year
Revenue bonds	\$ 63,430	\$ -	\$ (3,905)	\$ 59,525	\$ 4,080
Less premium/deferred amount on refunding, net	(3,035)	393	-	(2,642)	(363)
Total bonds payable, net	60,395	393	(3,905)	56,883	3,717
Compensated absences	1,837	3,222	(2,129)	2,930	1,333
Closure and postclosure care costs	173,491	13,165	(5,435)	181,221	9,284
Total other long-term liabilities	175,328	16,387	(7,564)	184,151	10,617
Total long-term liabilities	\$ 235,723	\$ 16,780	\$ (11,469)	\$ 241,034	\$ 14,334

Long-term liability activities for the year ended June 30, 2002 were as follows:

Long-Term Liabilities	Balance July 1, 2001	Additions	Reductions	Balance June 30, 2002	Due Within One Year
Revenue bonds	\$ 67,160	\$ -	\$ (3,730)	\$ 63,430	\$ 3,905
Less premium/deferred amount on refunding, net	(3,429)	394	-	(3,035)	(393)
Total bonds payable, net	63,731	394	(3,730)	60,395	3,512
Compensated absences	1,271	2,002	(1,436)	1,837	247
Closure and postclosure care costs	166,667	7,239	(415)	173,491	5,209
Total other long-term liabilities	167,938	9,241	(1,851)	175,328	5,456
Total long-term liabilities	\$ 231,669	\$ 9,635	\$ (5,581)	\$ 235,723	\$ 8,968

NOTE 8 - ACCRUED CLOSURE AND POSTCLOSURE CARE COSTS

State laws and regulations require IWMD to place final covers on its landfill sites when the landfills stop accepting waste and to perform certain maintenance and monitoring functions at the sites for a minimum of 30 years after closure. Although closure and postclosure care costs will be paid only near or after the date that each respective landfill stops accepting waste, IWMD is required by GASB 18 to report a portion of these closure and postclosure care costs as an operating expense in each period based on the landfill capacity used as of each statement of net assets date.

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NOTE 8 - ACCRUED CLOSURE AND POSTCLOSURE CARE COSTS (CONTINUED)

IWMD owns or operates the following waste disposal sites:

- Frank R. Bowerman (FRB) (Irvine - Active)
- Olinda Alpha (Brea - Active)
- Prima Deshecha (San Juan Capistrano - Active)
- Santiago Canyon (Orange – closed in 2001)
- Coyote Canyon (Newport Beach - closed in 1995)

All active waste disposal sites, (FRB, Olinda Alpha and Prima), are owned by IWMD. Santiago Canyon's lease with Irvine Company was terminated in November 2002 and in return the Irvine Company donated the landfill valued at \$1,400 to the County of Orange. Coyote Canyon is owned by the Irvine Company and is under lease.

The \$181,221 balance reported as the landfill closure and postclosure care liability at June 30, 2003 represents the cumulative amount accrued based on the percentage of the landfill capacity that has been used to date (39.23%), less actual costs disbursed related to the closure of the Coyote Canyon landfill. IWMD will recognize the remaining estimated cost of closure and postclosure care of \$164,067 as the remaining estimated capacity is filled. These amounts are based on what it would cost to perform all closure and postclosure care in fiscal 2002 dollars. Actual costs may be higher or lower due to inflation, changes in technology or changes in regulations. IWMD has landfill capacity permits to operate until the year 2040. With proposed expansion plans, however, IWMD intends to operate the landfills well beyond this date.

In compliance with the California Integrated Waste Management Board's regulations, IWMD has elected to make cash contributions to escrow funds to finance closure costs and has executed a pledge of future revenue agreement to ensure that adequate funds are available to carry out postclosure care of all landfills. Accordingly, IWMD, on an annual basis, sets aside cash for FRB, Olinda Alpha, Prima Deshecha and Santiago Canyon into restricted escrow funds held by the County. As of June 30, 2003 and 2002, funds in the amount of \$141,528 and \$120,913 for closure, respectively, have been reserved and are included as restricted assets in the accompanying statements of net assets as Pooled cash and investments – closure and postclosure care costs. The State-mandated formula under which these contributions are computed will provide for the accumulation of sufficient cash to cover all estimated closure and postclosure care costs when each site reaches maximum capacity. IWMD expects that future inflation costs will be paid from interest earnings on these annual contributions. However, if interest earnings are inadequate or additional closure and postclosure care requirements are determined (due to changes in technology or applicable laws or regulations, for example), these costs may need to be covered by charges to future landfill users.

Regulations governing solid waste management are promulgated by government agencies on the federal, state and local levels. These regulations address the design, construction, operation, maintenance, closure and postclosure maintenance of various types of facilities; acceptable and prohibited waste types; and inspection, permitting, environmental monitoring and solid waste recycling requirements. Regulations at both the state and federal levels could impose retroactive liability, particularly with respect to cleanup

COUNTY OF ORANGE
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NOTE 8 - ACCRUED CLOSURE AND POSTCLOSURE CARE COSTS (CONTINUED)

activities, relating to any landfill site ever operated by the County, whether or not owned by the County. Thus, the County has potential liability with respect to every landfill ever operated by the County. Compliance with these regulations may be costly, and, as more stringent standards are developed to protect the environment, these costs could increase.

NOTE 9 - COMMITMENTS AND CONTINGENCIES

Litigation

IWMD is involved in various regulatory and other legal actions, which occur in the normal course of its operations. Management believes that the ultimate outcome of these matters will not have a significant effect on the financial position or results of operations of IWMD.

Sparkes Pit /Rains Refuse Disposal Station #18 – Regulatory Action

Located in the City of Anaheim, Sparkes Pit is a refuse disposal station formerly leased to and operated by the County from 1958 to 1960. The State Water Board and other regulatory agencies and the Anaheim Redevelopment Agency (ARA) are seeking certain improvements to the site including surface improvements, the installation of a landfill gas system upgrade and/or installation of a new landfill gas system.

The ARA has been pursuing locating a commercial development, called the Anaheim Westgate Center, on this closed disposal station since 2000. In June 2003, the City of Anaheim purchased the Sparkes parcel of the site to facilitate this commercial development. In March 2003, the ARA asserted that the Polanco Act gives them authority to recover from the County and the Rains property owner, project development costs related to the past use of the property as a disposal station. The County and the ARA are not in agreement as to the costs recoverable pursuant to the Polanco Act and the County disputes whether the ARA has met the procedural requirements of the Polanco Act. The County and the ARA are currently in negotiations as to what costs, if any, are the responsibility of the County.

The Rains property owner has claimed that County is obligated to indemnify him if he incurs any damages as a result of the ARA actions. The County has declined the Rains property owner's tender of indemnity obligations. The Rains property owner has not filed a formal claim with the County.

It is possible that the County will incur costs as a result of these actions and/or claims or regulators, the ARA, and/or the Rains property owner. Although the ultimate costs, if any, are unknown, they may be significant. However, the County's Chapter 9 discharge may be a relevant defense to this matter. At this early stage, it is not possible to predict the outcome of these actions or the success of any of the defenses asserted by or available to the County.

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NOTE 9 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Cannery Street Refuse Disposal Station #4

A park owned by the City of Huntington Beach is located on a site that was formerly used as a refuse disposal station operated by the County of Orange from 1957 to 1969. Methane gas was detected on the property. The Local Enforcement Agency (LEA), the entity that regulates landfills, ordered the City and the Huntington Beach School District to develop a plan to control the landfill gas at the site. The City of Huntington Beach is in the process of implementing the landfill gas mitigations required by the LEA. The County cannot estimate the cost to control landfill gas. The costs, however, could be substantial. The City has notified the County that it is their position that the County is responsible for control of landfill gas from that site. The City, however, has not yet filed a claim. The County denies that it is responsible. It is possible, however, that the County could incur significant costs if the matter results in litigation.

La Habra Refuse Disposal Station #11

A park owned by the City of La Habra is located on a site that was formerly leased and used as a refuse disposal station operated by the County of Orange. The site was operated by the City for refuse disposal prior to 1949 and by the County between 1949 and 1958. Methane gas was detected on the property. The LEA, ordered the City to develop a plan to control the landfill gas at the site. , The City of La Habra is in the process of implementing the landfill gas mitigation required by the LEA. The County cannot estimate the cost to control landfill gas. The costs, however, could be substantial. The City has notified the County that it is their position that the County is responsible for control of landfill gas from that site. The City, however, has not yet filed a claim. The County denies that it is responsible. It is possible, however, that the County could incur significant costs if the matter results in litigation.

San Joaquin Refuse Disposal Station #13

The site, owned by the University of California at Irvine, was leased and operated by the County of Orange as a refuse disposal facility from 1954 to 1961. In 1996, a portion of the site was sold to the Food and Drug Administration. Methane gas was detected on the property. The LEA, ordered the University to develop a plan to evaluate landfill gas mitigation. The County cannot estimate the cost to control landfill gas. The costs, however, could be substantial. The University has notified the County that it is their position that the County is responsible for control of landfill gas from that site. The University, however, has not yet filed a claim. The County denies that it is responsible. It is possible, however, that the County could incur significant costs if the matter results in litigation.

Forster Refuse Disposal Station #17

The site, located in the City of San Juan Capistrano was formerly leased and operated as a refuse disposal station by the County of Orange from 1958 to 1976. The current owner is proposing a change in land use for the property and has notified the County that it is their position that the County is responsible for closure of the site. The County cannot estimate the cost to close the site. The costs, however, could be substantial. The owner has not initiated litigation. It is possible, however, that the County could incur significant costs if the matter results in litigation.

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NOTE 9 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Lane Road Refuse Disposal Station #21

The site located in the City of Irvine and owned by NGP Realty Sub, L.P and others, was leased and operated by the County of Orange as a refuse disposal facility from 1961 until its closure in 1964. The Santa Ana Regional Water Quality Control Board and LEA issued a Directive to the property owner to investigate the presence of landfill gas and its impact on groundwater. That investigation has indicated that landfill gas is present above regulatory limits in close proximity to residential housing units. The LEA issued a Notice and Order in January 2003 directing the property owner to develop a corrective action work plan and a proposed long-term landfill gas remediation plan. Counsel for the property owners have indicated that it is their position that the County is responsible for all costs associated with the control of landfill gas at this site. The County disputes this assertion. In February 2003, the property owners submitted a Claim for Money or Damages to the County for \$70,000 (as of the claim filing date) and anticipate future damages in excess of \$1,000,000. IWMD and its counsel are currently in discussion with the property owners to negotiate a settlement agreement. It is possible the County could incur significant costs if the matter results in litigation.

Other Contingencies

As the owner and operator of a number of landfill sites, IWMD has potential exposure to environmental liability. IWMD may be required to perform corrective action for contaminant releases at any of its closed refuse disposal stations, even if the County no longer owns the property. On the basis of information currently available to management, IWMD management believes it has sufficient reserves for known and anticipated remediation costs. At June 30, 2003, amounts accrued for reserves totaled approximately \$64.2 million.

Commitments Under Operating Leases

IWMD leases various equipment used at the waste disposal sites on a short-term basis and office space under operating leases, which are primarily on a month-to-month basis. Total future minimum lease payments under noncancelable lease agreements with terms greater than one year as of June 30, 2003 and 2002 are not significant.



Macias, Gini & Company LLP
Certified Public Accountants and
Management Consultants

515 South Figueroa Street
Suite 325
Los Angeles, CA 90071

213•612•0200
213•286•6426 FAX
www.maciasgini.com

Board of Supervisors
The County of Orange, California

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

We have audited the financial statements of the County of Orange Integrated Waste Management Department (IWMD), an enterprise fund of the County of Orange, California (County), as of June 30, 2003, and have issued our report thereon dated October 23, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether IWMD's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit we considered IWMD's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Supervisors, IWMD management, and grantor agencies, and is not intended to be and should not be used by anyone other than these specified parties.

Maurer, Fini & Company LLP

Certified Public Accountants

Los Angeles, California

October 23, 2003